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Investment Management Perspectives

2017 Year-to-date US Equity Performance

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Through May 31, the S&P 500 is up 8.7% (including dividends) for the year. One-third (33%) of this return has been driven by five large technology companies.

Contribution to Return through May 31	
Apple Inc.	1.1%
Amazon.com, Inc.	0.5%
Facebook, Inc. Class A	0.4%
Microsoft Corporation	0.3%
Alphabet Inc. (Class A & C)	0.6%
Total	**2.9%**

We reviewed annual returns of the S&P 500 back to 1991. During that time, there were 4 years with negative returns, 3 years with flat returns (0% - 1.5% which was entirely attributable to dividends) and 19 with positive returns. For the 19 years with positive returns, the average contribution of the top 6 stocks was 25%. Although it is typical for 6 or 7 stocks to account for roughly 25% of market returns in any given year (as we also note in our June Viewpoint), this level of concentration - 5 stocks accounting for 33% of the return - is not.

This year's contribution by the top 5 of 33% has only been exceeded twice (1999: 40% and 2007: 53%). If you remember your stock market history, 1999 and 2007 were both years preceding very sharp declines in stock prices. With seven months remaining in 2017 our hope is that market breadth starts to improve. We are also seeing some considerable divergences between large and small stocks and between growth and value stocks.

Many active money managers have a bias towards small and midcap value stocks. As you can see from the tables below, that is having a large negative impact on performance for active money managers.

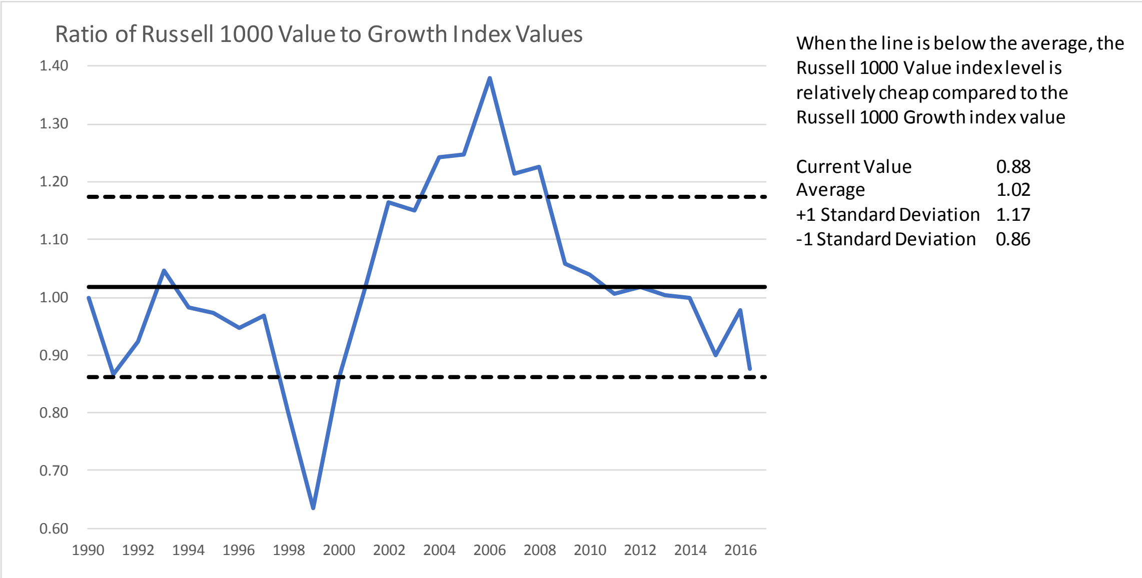
Stock Returns - Size Matters
through May 31

	YTD	2016
S&P 500 (TR)	8.7%	12.0%
S&P Mid Cap (TR)	4.3%	20.7%
S&P Small Cap (TR)	-0.2%	26.6%

Stock Returns - Style Matters
through May 31

	YTD	2016
Russell 1000	8.5%	12.1%
Russell 1000 Growth	14.3%	7.1%
Russell 1000 Value	3.0%	17.3%

Value stocks have struggled since the financial crisis. Like many things in financial markets, we see multi-year trends where value or growth will have an extended run of outperformance. The chart below shows the relative performance of the Russell 1000 Growth Index vs. the Russell 1000 Value Index. Beginning in 1999 value stocks had seven years of outperformance which ended in 2006. Since then, growth stocks have had a decade of outperformance.



We haven't done the analysis but our bet is that this chart has a high correlation with hedge fund outperformance. Hedge funds flourished from 2000 up to the financial crisis. Many hedge fund portfolios are comprised of being long value stocks and short growth stocks which would have made you look like a genius from 2000 to 2006 and like an idiot since then. We are seeing more stories regarding the death of hedge funds which may be an indicator that we are getting set for a reversal of the relationship between value and growth.

Sources: Fact Set 2017

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